DOW THEORY LETTERS INC.

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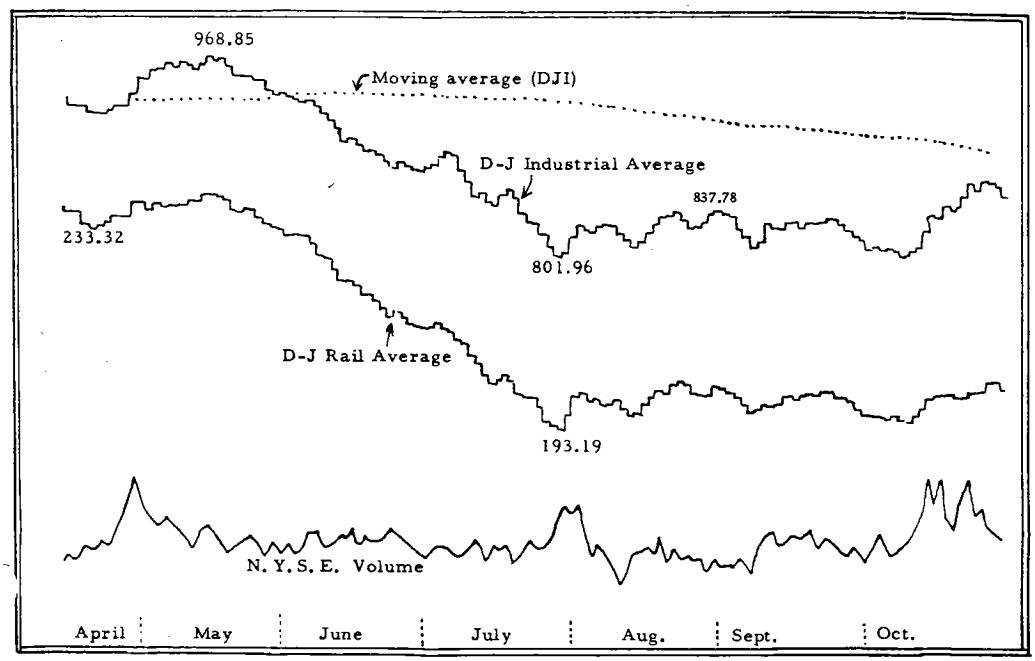
THE MARKET: On October 22 the Labor Dept. reported that the Consumer Price Index rose in October at an annual rate of 6%, up from 4.8% the previous month. In so doing the Index rose to 129.3% of the 1957-59 average. This was a record high, up from the previous August record of 128.7%.

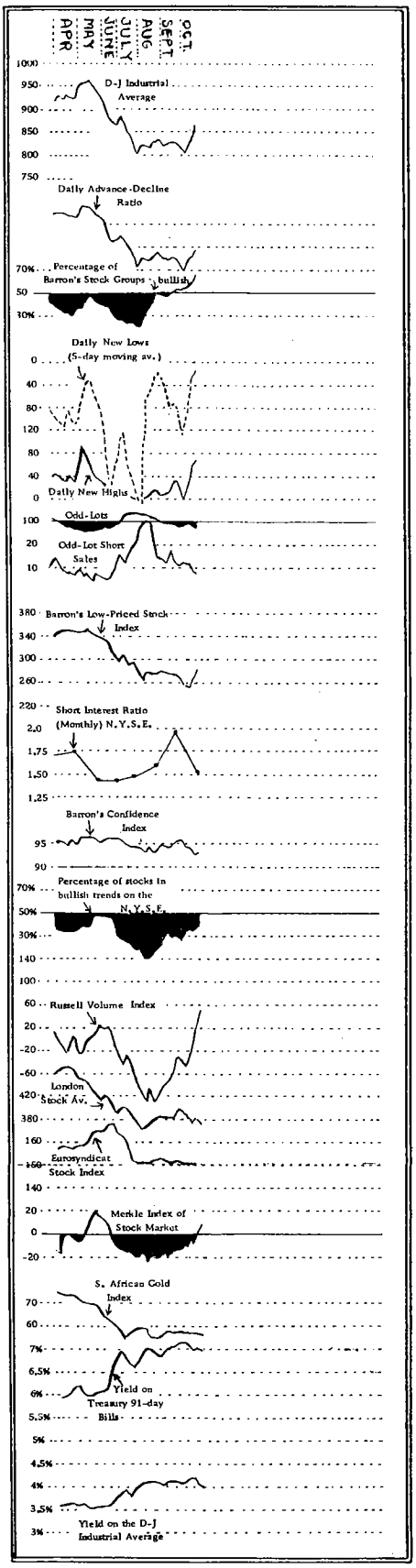
Thus, the Administration has again been foiled in its "anti-inflation" efforts, and it was forced to fall back on the quarterly Cost of Living figures, which appear less inflationary than the up-to-date monthly figures. The fact is that on the inflation front, as on the Vietnam front, the Administration has so far failed to face the truth.

In Vietnam, the choices are the military one, to "make a desert and call it peace" or to scale down the war, hope the American people will accept the mini-war, and in that way possibly keep S. Vietnam from actually falling into the hands of Hanoi. The third solution is to pull out entirely, announce that it is now Saigon's war, and hope that Hanoi does not take over until after the next Presidential election.

On the inflation front, the choices are just as grim. It is apparent that after almost a year of right money, the present monetary policy has produced no real results. Therefore, the choice is to do something else (for instance, price and wage controls) or to retain the present tight money policy in the hopes that time will ultimately slow the inflationary forces. The final direction would be to ease up on money and simply announce that there is no reasonable way to stop inflation. The last procedure is almost unthinkable, and it therefore appears to me that the choices remain as follows: Keep stringent monetary policies or even tighten monetary restrictions further— or bring in wage and price controls.

My own opinion is that as long as business remains reasonably good and as long as speculative interest remains intact, business and the general public will tend to ignore anti-inflation policies. Furthermore, there seems to be a grounswell in





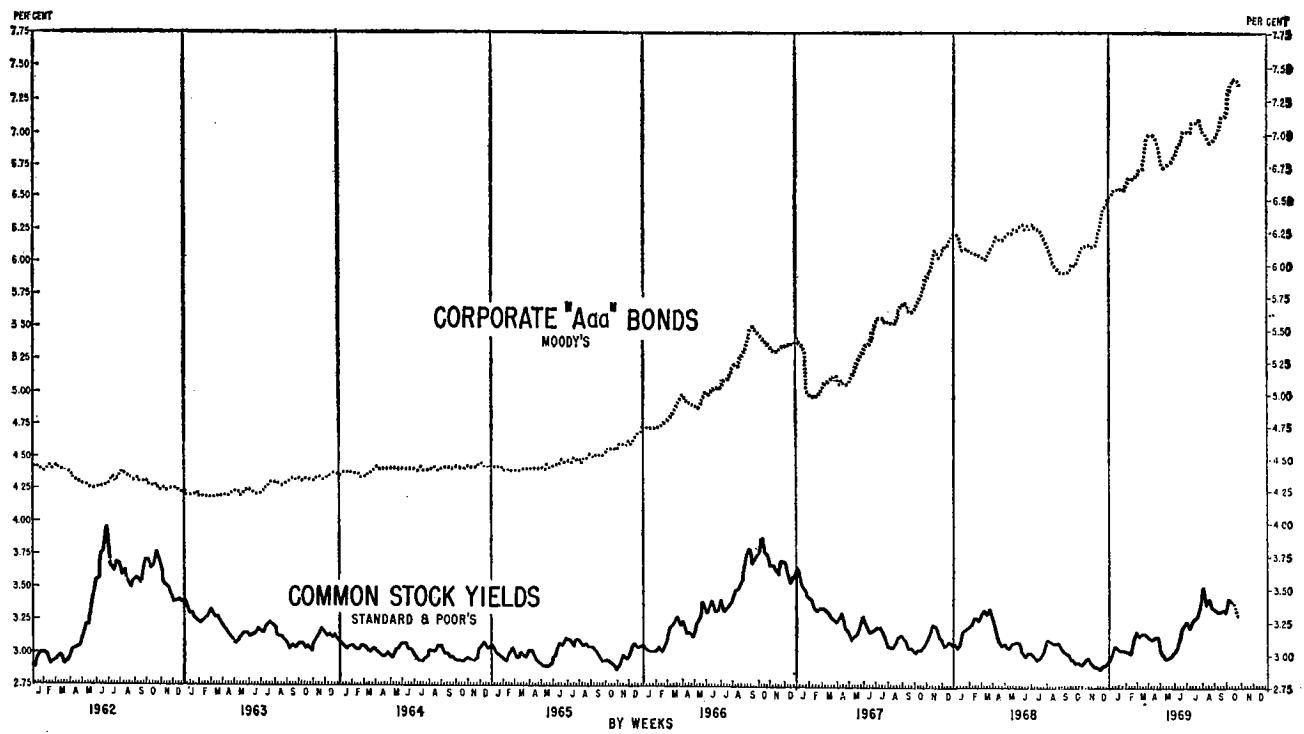
opinion to the effect that the Administration and the Fed will "ease up" on monetary policy between now and the first quarter of 1970. Meanwhile, not a day goes by without producing notices of price increases in one segment of the economy or another. For instance, on the day the new Consumer Price increase was posted (October 22), giant Owens-Illinois posted 3% to 6% price increases on all bottles and jars, while raising their warehouse charges 50%. On the same day Datsun announced a 2% price increase on all 1970 basic model cars.

Perhaps the most interesting comment I've seen this week on the monetary-economic situation comes from outspoken economist-author Elliot Janeway. In his newspaper column of September 29 he writes: "Every sign this (writer) sees on the market horizon is pointing to a rise and not a fall in the demand for money. As fast as statistical officialdom is buoying its confidence in the drop that isn't developing, participants in the economy are speeding up the pace at which they are reaching for every borrowable dollar in sight, at whatever price. That's why the price of money is continuing to rise and, as it does, to signal still more dangerous highs for the inflationary spiral."

To me, the whole stock market today can best be described in terms of temporary psychological reversals and bursts of speculative enthusiasm— all within the framework of the relentless primary bear trend. It reminds me of two airline pilots sitting in a plane which has run out of gas and is gliding down towards the inevitable crash, and all the while while they are arguing about whether they will get dates with the two stewardesses aboard the plane. In the five minutes to go before the plane crashes, they might indeed get dates, but they are dismally unaware of the big picture.

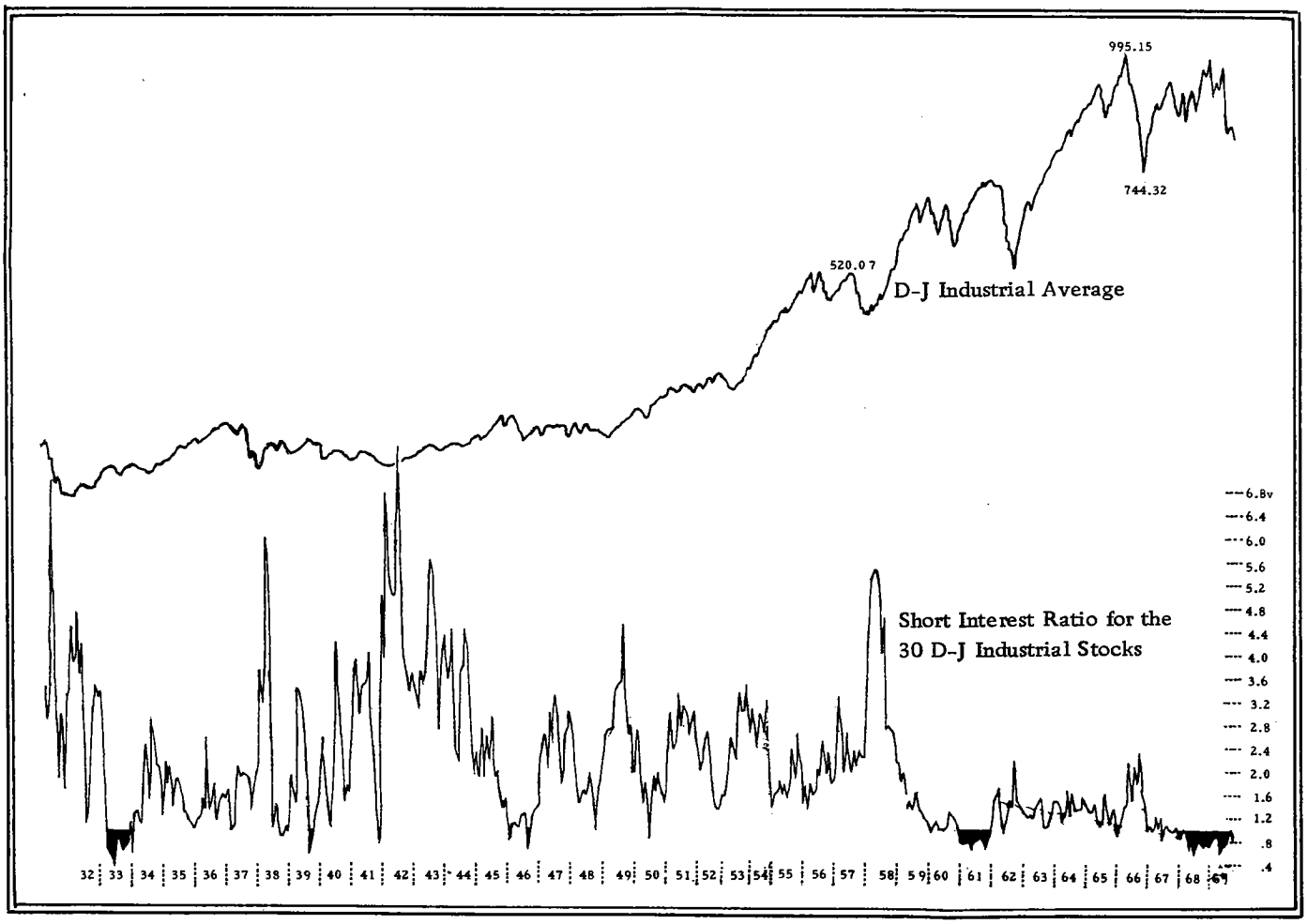
On October 22 the A-D ratio confirmed the Industrial advance by moving above its August A-D ratio high. A few days later, on October 28, the Rails confirmed by pushing fractionally above their own August peak of 202.02. Technically, the way is now open for further gains on the upside. However, I warn subscribers that the secondary technical situation is always of subsidiary importance to the over-riding consideration of the direction of the primary trend of the market. The primary trend has been bearish since February, 1966. All extensions, halts and counter-movements against the primary trend will merely render the ultimate expression of the bearish forces that are much more violent. The violence on the downside still lies ahead.

I continue to feel that distribution is going on, and this was underlined on the week ending October 24, when, with 79.5 million shares traded, a tabulation showed that 11 of the 20 most active stocks for the week ended down. Furthermore, no bull market that I have ever heard of started with a massive drop in the total short interest such as the one which was registered during October. Finally, it may be noted that stocks are currently still very sensitive to bad news. During the early stages of a true primary bull market it is characteristic of individual issues that they are almost totally imprevious to publication of adverse news or earnings reports.



On the week ending October 24 the Moody's Aaa bond index indicated a yield of 7.38%, while the Standard & Poor 500 stock average provided a yield of 3.31%. The resultant differential (see chart) showed a negative spread of 4.07% in favor of bonds. This was the greatest spread in favor of bonds in market history, hardly an indication of the birth of a new bull market in stocks!

For the record, the stock-bond yield differential last week was greater than the total average yield on the S & P 500 stock average.



DOW SHORT INTEREST: I am going to bring up-to-date an important technical study which I have not reviewed since last June (Letter 429). This is the indicator developed by Bill Gordon of New York, the short interest ratio in the 30 Dow Industrials. As mentioned before, I like the DSI ratio indicator because (1) it renders very few signals, (2) when it does give a signal, the signal is unmistakably clear, and (3) the indicator is not widely followed. As far as I know, Bill Gordon is the only man in the country who computes the DSI ratio each month, and he is kind enough to send these figures to me. To my knowledge, this is the only service which publishes an historical chart of the ratio.

I have included the up-dated chart of the DSI ratio with this Letter. Note that there are only three periods in history in which the DSI held under the critical 1.0 level for any length of time. The first was during 1933, one year after the lows of the greatest bear market in history. The 1933 period was followed by a violent and unexpected decline which began with the panic of July, 1933 and extended to July, 1934.

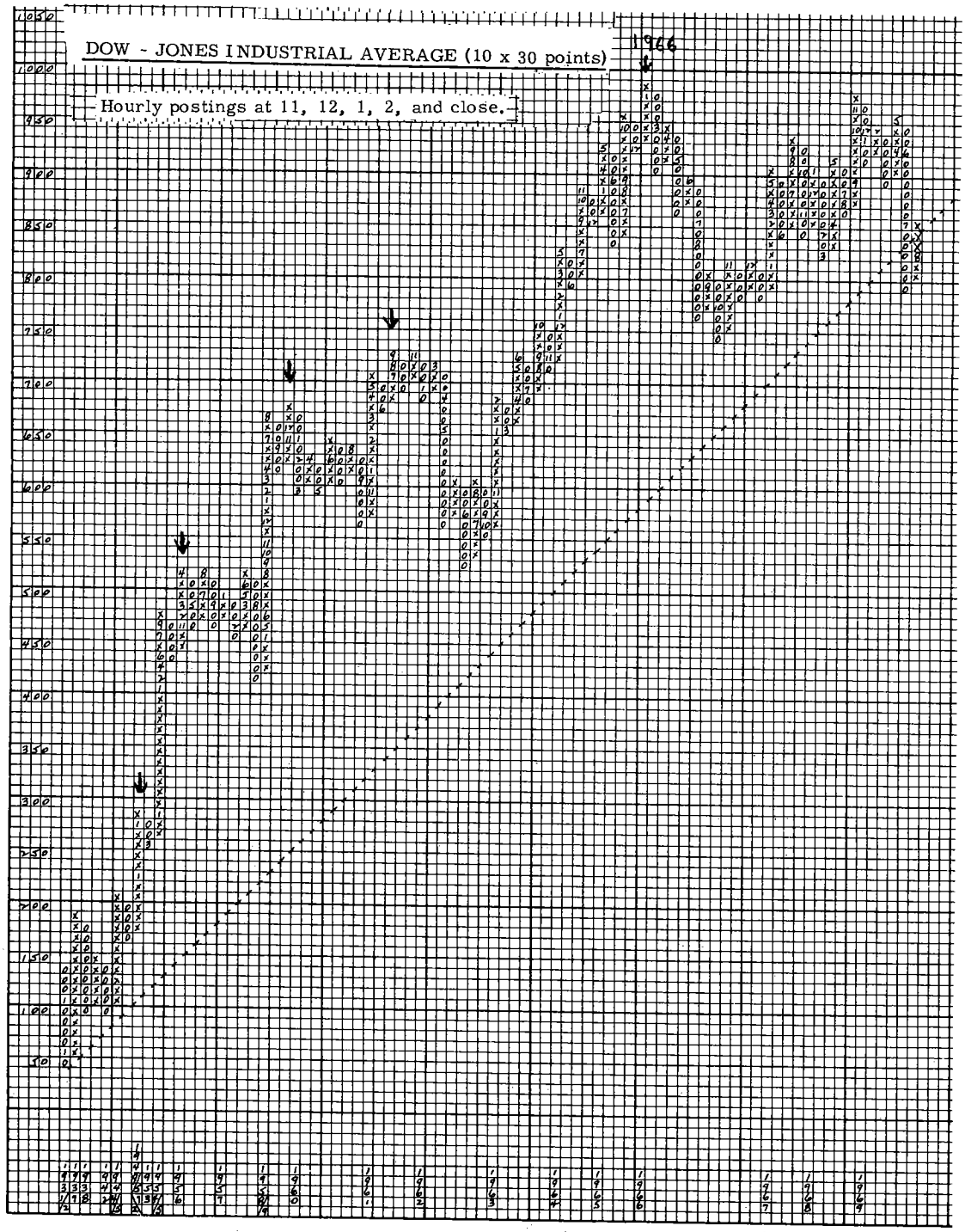
The second extended journey of the DSI under 1.0 was during the year 1961, and this was followed by the market smash which began in mid-December, 1961, extending to October, 1962. The 1962 collapse was preceded by 13 months during which the DSI held under 1.0.

On January, 1968 (see chart) the DSI slipped under 1.0 to .85. Except for the two months of March, 1968 (DSI 1.13 in March, 1968) and September, 1969 (DSI 1.04 in September, 1969), the DSI has held under the 1.0 level ever since January, 1968. Thus this indicator has been under the 1.0 level for 20 out of the last 22 months, forming a danger zone without parallel in the history of the DSI.

Towards the end of 1969 I drew repeated attention to the "danger signals" being rendered month after month by the DSI. I wrote that if the market did not respond to these signals it would be the first time that the DSI, following an extended

period in the under-1.0 zone (black zone on chart) had been wrong. The drastic declines of December, 1968 to February, 1969 and of May through July, 1969 verified the fact that the DSI was indeed correct in its forebodings.

In September, 1969, the DSI climbed temporarily above the 1.0 level to register a reading of 1.04. This was the second month since January, 1968, to witness an above-1.0 reading on the DSI. Last week I received my monthly letter from Bill Gordon. With high volume and 727,000 shorts in the 30 Dow stocks, the DSI fell, in October, to .78. As far as I am concerned, the message of the DSI is still "danger ahead." With 20 out of 22 months in the black or danger zone, it would seem that the DSI is continuing to shout its warning. I have presented the history of the DSI in chart form in this Letter. Study it and draw your own conclusions.



LONG-TERM: A study of this point and figure chart should now be instructive. The chart, as explained in Letter 441, is a 10 point chart (each square represents 10 points on the Dow Industrial Average), and only rallies or declines of 30 points or more are shown. Rallies are designated by vertical rows of X's, declines are shown by vertical rows of O's.

I have drawn an arrow above major peaks in the Dow since the year 1932. The phenomenon that becomes immediately apparent to me is the huge mass of fluctuations since the 1966 peak. There are 26 vertical rows (so far) following the 1966 peak, and it should be remembered that each of these vertical rows represents a rally or decline of 30 points or more. That is a fantastic amount of "traveling" for the Dow since the bull market peak of 995.15 recorded during February, 1966.

In duration, the Dow has been fluctuating under the 1966 high for over three-and-one-half years. The last time a lapse of this length occurred following a Dow peak was in 1937. Following the 1937 market crash it took nine years, or until 1946 for the Dow to better the 1937 bull market peak.

After the '37 crash, it took five years (until 1942) for the Dow to touch its bear market bottom. Then it required another four years or into 1946 before the Industrial Average bettered the old 1937 high of 194.40. Now remember, the bull market of 1932 to 1937 lasted only five years. In duration, it did not compare to the late bull market of 1949 to 1966. Does it make sense that following the 17-year bull market of 1949-1966, the ultimate bottom would be struck eight months later (i.e., October, 1966) at 744.32 on the Dow? To me, it simply is not logical, and if I had to guess I would venture that the final bottom for the bear market which began in 1966 will be struck perhaps some time in 1971 or 1972 at a point well below the 744.32 level.

In the meantime, I view all the action (see chart) since 1966 as part of a giant distribution of stocks. I believe that the longer this distribution goes on and the the greater the horizontal "count" on this chart (it is now 26 rows), the more severe will be the ultimate finale for the bear market. In the meantime, those of us who believe that we are continuing in this fantastically "difficult" zone prior to the next major bear market collapse, have only one sane course to follow. That course is to take the position that all bear markets are deceptive, and that this is one of the most deceptive in all stock market history. Policy entails staying out of the market, regardless of its gyrations and fluctuations, until the primary bear trend has full run its course.

So far, I see nothing to suggest that the bear market touched its final bottom either during 1966 (October) or in 1969 (Oct.). In the meantime, great patience is required plus an intellectual belief that every great bull market gives birth to a major bear market. So far, the bear market action of 1966 and 1969 has only provided hints of the major correction which is fated to arrive.

CONFUSION: I note a gathering confusion in this nation and actually across the face of the Free World. There seems to be a massive split between the forces of conservatism and the forces of liberalism. The split is as absurd as are the extremists on both sides.

One side of the problem is that the conservatives have lumped conservative or sane fiscal policies together with "up-tight" or restrictive attitudes towards people. Conservative monetary policies are equated with "squareness" and emotional restriction.

On the other hand, the forces of "human potential," the youth movements and the political and emotional liberals know nothing about finance and they have somehow equated expanding the horizons of the human soul with jettisoning all efforts towards economic sanity.

I have never, in all my reading, come across anyone who sees that this idiotic split need not be. In my opinion, the two forces which must come together if this nation is to survive in anything like its present form are the forces of human potential and the forces of economic sanity.

President Nixon, it seems to me, fails on both counts. I believe his true nature tends towards some form of economic conservatism together with an unfortunate emotional conservatism. But he lacks conviction on either count, and the result is a rather hazy picture of a man, aimless, wishy-washy, and colorless. As one leading Washington writer put it, "Nixon dabbles in everything and gets into nothing."

When trouble strikes Mr. Nixon's only urge is to withdraw from the danger, rather than confront it. This is coupled with a curious stubborness which I associate with someone who lacks deep intellectual or emotional convictions. It is the "leave it alone and maybe it will go away" psychology. It's a non-think policy which is not good enough for this nation today, as I am certain time will prove.

In my opinion, it is possible to have a nation which is strong, well-balanced, financially sound and emotionally happy, just as it is possible to have an individual who possesses those same attributes. Sooner or later America will have to produce an

 enlightened leader who can bring the best and sanest parts of this nation together. Until that time, I see the problems of this country looming larger and larger and the split between the liberal and conservative elements growing wider and wider.

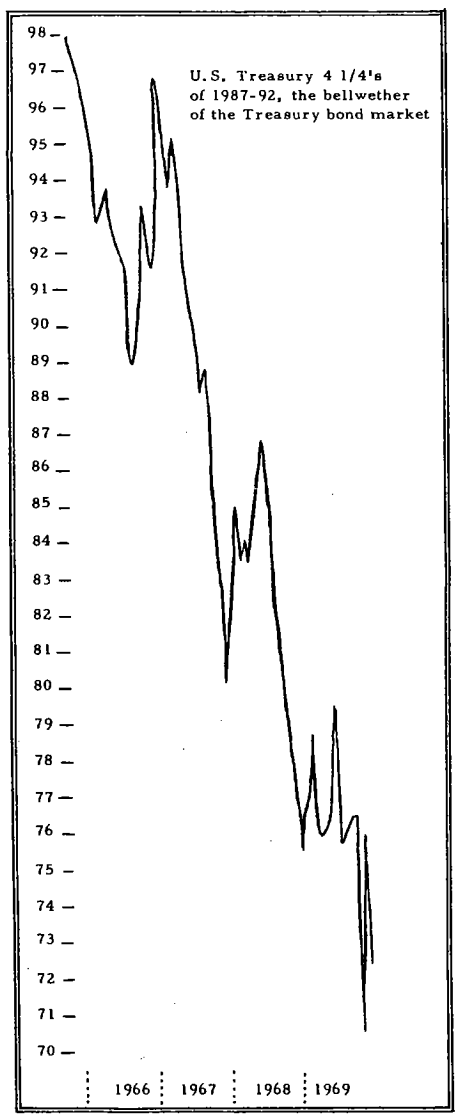
I find it most interesting to study the direction of Life magazine, a magazine which boasts a huge circulation but one which must also appeal to that circulation. In the last two issues, Life has featured articles on revolution, the "M-day" dissent, the new, young writers and the new super-rock group, "Blind Faith." Life has found it both desirable and necessary to move towards the forefront of what people are thinking about and talking about. They have moved out of the conservative fold, out of the neutral fold, and into the human potential (and even the protest) zone. Unfortunately, Life's economic "thinking" seems to have traveled in the same direction. I have read nothing in Life which makes sense economically to me.

Time magazine, which had become stale and synthetic in its totally boring brand of conservatism, is now trying desperately to come alive. It is attempting to become humanized by using signed articles and dropping its didactic pretense of telling us all how to think and act.

Meanwhile, America has all but given up the quest of self and emotional fulfillment and turned to something much easier, the quest for a big house and three cars in every garage. American advertising and business has sold itself and its customers on a road which leads to expensive fun without happiness. The protest movement senses this, but in its anger and frustrations it is bent on destroying the greatest economic vehicle in history.

It is always easier to destroy something outside oneself than to build something within oneself. The liberals and radicals will have to face that before long. Otherwise, it will be the fire next time.

WHIP-SAW: I include my chart of the Treasury $4\frac{1}{4}$ of 1987-92, the bellwether of the Treasury bond market and the bond every bond investor watches. The incredible collapse of this bond since 1966 correctly reflects the smash in the entire Treasury market, a smash which has erased hundreds of millions of dollars from bank and investor portfolios.



On September 30, 1969, this bond hit a record low bid of 70 and 20/32's, then bounced to an October 21 recovery peak of 76 and 12/32's. This action brought cheers to both stock and bond traders, and the word was that the "bond market is anticipating an easing of tight money."

Last week saw long-maturity Government bonds post one of their worst price performances on record. By Oct. 28 the $4\frac{1}{2}$'s of 1987-92 had given up two-thirds of their October rally gains and were selling at 72 and 12/32's bid. The decline since the hopeful October 21 high has been, as one bond trader put it, "breathless."

SILVER: In my opinion, the reaction in silver ended during July and August. The price of silver is slowly marching up, and as seen on the three silver charts below, the silver stocks are in the process of reversing to the upside. I see nothing wrong with long-term positions in any of the three stocks listed below. Somewhere ahead I see a run on silver, and the silver stocks, after reactions, are in a buying range.